City of San Diego

CARL DEMAIO
CITY COUNCILMEMBER – DISTRICT 5

DONNA FRYE
CITY COUNCILMEMBER – DISTRICT 6

MEMORANDUM

DATE: July 16, 2009

TO: David Wescoe, SDCERS Administrator
Members of SDCERS Pension Board

FROM: Councilmember Donna Frye Donna Frye

Councilmember Carl DeMaio Carl DeMaio

RE: "Educational Overview" of Other Public Pension Plan Actions

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We are in receipt of your July 2, 2009 memorandum regarding the *education* of the SDCERS Pension Board on *what other public pension plans in California and around the country are considering in light of FY 2009's investment returns.* The memo goes on to specifically list CalPERS' *recently modified smoothing methodology to ease the impact of FY 2009 investment losses* as an example.

A review of the actions taken by CalPERS reveals that **the CalPERS Board approved changes to the corridor limits for the actuarial value of assets that it had in place** for the June 30, 2009, and June 30, 2010 valuations (June 17, 2009 Meeting Minutes attached).

The manipulation of actuarial assumptions in order to artificially lower payments (i.e. deliberately underfund the pension system for short-term budgetary expediency) played a large role in undermining the city's financial health, and the city should not be allowed and/or encouraged to repeat the same mistakes by the plan administrator. Furthermore, following the example of other struggling pension plans may not necessarily lead to the most prudent course of action for taxpayers and retirees.

As such, we strongly suggest removing any such actions from consideration, and urge the Pension Board to prevent any further discussion of these actions outright before the notion of their implementation begins to gain any momentum.

Finally, as of the end-of-business, July 15, 2009, the supporting materials (labeled "Tab 7") for this item have yet to be provided as part of the meeting agenda. This is troubling, as it is difficult for the public to provide meaningful input on such an important issue without these materials being made available in advance.

Attachments:

1) CalPERS Agenda Item #14, June 17, 2009

CC: Mayor Jerry Sanders
Jay Goldstone, COO
Members of the "Ad Hoc Committee" on Actuarial Assumptions (Identities Unknown)
City Councilmembers
Andrea Tevlin, Independent Budget Analyst

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June 17, 2009

AGENDA ITEM #14

TO: MEMBERS OF THE BOARD OF ADMINISTRATION

I. SUBJECT: Impact of Economic Environment on Employer Rates and Possible Smoothing Modifications (Second Reading)

II. PROGRAM: Retirement

III. RECOMMENDATION:

That the full CalPERS Board approves the adoption of the following smoothing changes:

- Increase the corridor limits for the actuarial value of assets from 60%-120% of market value to 80%-140% of market value on June 30, 2009
- Reduce the corridor limits for the actuarial value of assets to 70%-130% of market value on June 30, 2010
- Return to the 80%-120% of market value corridor limits for the actuarial value of assets on June 30, 2011 and thereafter
- Isolate and amortize all gains and losses during fiscal year 2008-2009, 2009-2010 and 2010-2011 over fixed and declining 30 year periods (as opposed to the current rolling 30 year amortization)

IV. ANALYSIS:

At the May 2009 meeting, the CalPERS Board approved as a first reading modifications to the smoothing methods to phase in the impact of the investment loss in 2008-2009 over 3 fiscal years. Attachment 1 contains a copy of the May 2009 agenda item and all of its attachments.

Smoothing methods rely on the fact that over time one would expect gains and losses to cancel one another. As mentioned last month, we believe that the global market decline that has taken place in fiscal year 2008-2009 is a unique event. For this reason, we believe that this year should be handled differently and that it should be paid separately and outside the smoothing process. We do not want to rely on future investment returns to pay for the 2008-2009 investment losses.

Following is a table comparing the proposed method to the current method.

Comparison of Proposed and Current Methods

Valuation Date and Contribution Year	Current Method		Proposed Method	
	Corridor	Amortization	Corridor	Amortization
June 30, 2009 Valuation 2010-2011 rates State & Schools 2011-2012 rates Public Agencies	80%-120% of market value of assets	Rolling 30 Year Amortization of 08-09 Gains and Losses	60%-140% of market value of assets	Fixed 30 Year Amortization of 08-09 Gains and Losses
June 30, 2010 Valuation 2011-2012 rates State & Schools 2012-2013 rates Public Agencies	80%-120% of market value of assets	Rolling 30 Year Amortization of 09-10 Gains and Losses	70%-130% of market value of assets	Fixed 30 Year Amortization of 09-10 Gains and Losses
June 30, 2011 Valuation 2012-2013 rates State & Schools 2013-2014 rates Public Agencies	80%-120% of market value of assets	Rolling 30 Year Amortization of 10-11 Gains and Losses	80%-120% of market value of assets	Fixed 30 Year Amortization of 10-11 Gains and Losses
June 30, 2012 and all Future Valuations 2013-2014 rates and beyond for State & Schools 2014-2015 rates and beyond for Public Agencies	80%-120% of market value of assets	Rolling 30 Year Amortization of 11-12 and all Future Gains and Losses	80%-120% of market value of assets	Rolling 30 Year Amortization of 11-12 and all Future Gains and Losses

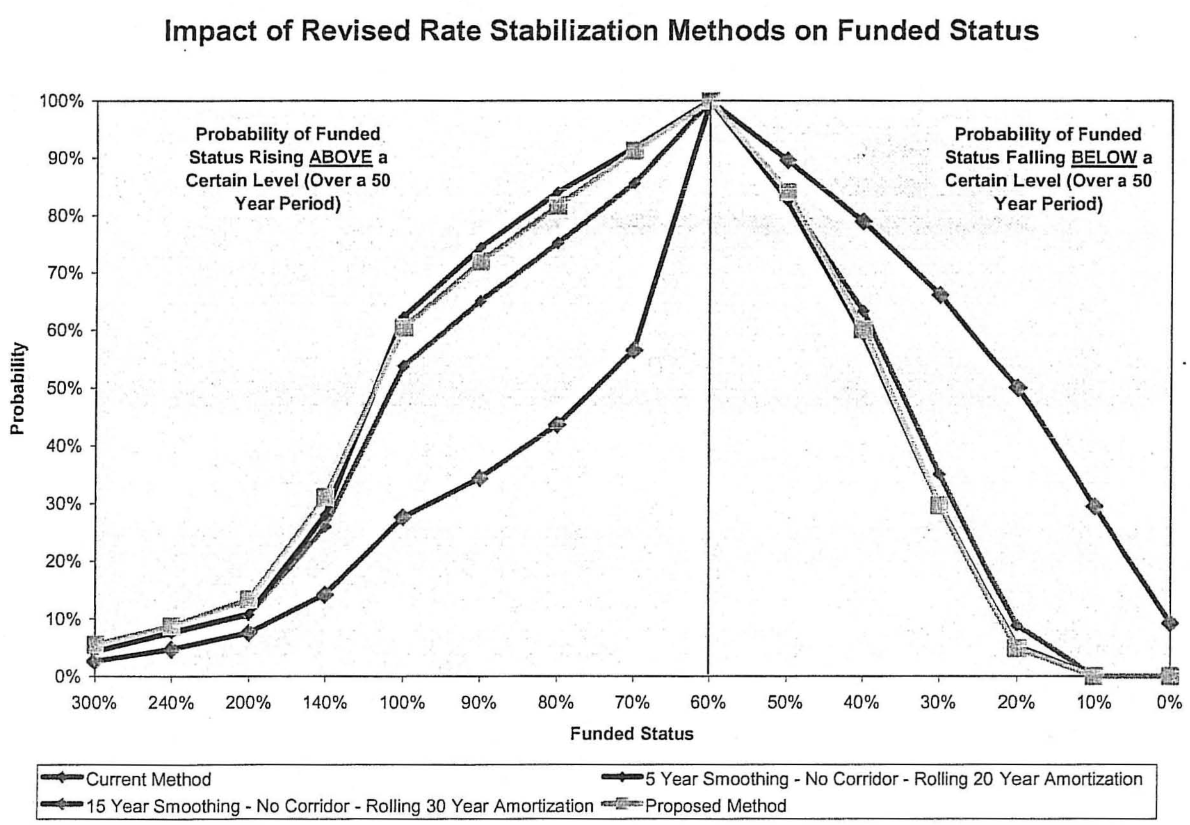
The May 2009 agenda item illustrated how plans with different asset to payroll ratio would be impacted differently by the decline in investment market. Attachments 2 thru 4 provide a side by side comparison of future employer rates over the next 5 fiscal years under the current and proposed methods for three sample employers with asset to payroll ratio of 4, 7 and 10 assuming a -30% investment return for 2008-2009 and reverting back to earning 7.75% in future years.

As can be seen in these three tables, to the extent CalPERS earns its assumed 7.75% investment return in the future, the employer rates are going to increase to levels we would see under the current methods but two years later. It is important to note that unless the investment markets recover, delaying increases in contribution rates means that rates after the three year period would have to be tenths of a percent higher.

Impact on Funded Status

Whenever changes to smoothing are considered, one of the most important risk measures to look at is the funded status of the plan. As was done back in 2005, the proposed change in the smoothing method was tested by developing the probability that the funded status will drop below certain levels and or increase above certain levels.

Below is the same graph that was included in the May 2009 agenda item. This is a graph showing the cumulative probability distribution of the funding status either falling below or increasing above the current level at any time over the next 50 years. Note that this graph was prepared assuming a -28% return for 2008-2009 which would result in CalPERS having a funded status slightly below 60% on June 30, 2009.



Another way of comparing the proposed method to the current method and the impact on the funded status is to look at the difference in expected funded status under both methods. If the Board was to approve the proposed smoothing changes instead of staying the course with the current method, the funded status would be expected to be greater over time compared to the current method. In fact, under the assumption that the 2008-2009 investment return would be -30% and 7.75% each year thereafter, the funded status 35 years from now under the proposed method for a sample plan with an asset to payroll ratio of 7 would be about 10% above what it would be under the current method.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic or Annual Plans but is part of the regular and ongoing workload of the Actuarial & Employer Services Division.

VI. RESULTS/COSTS:

See Above.

David Lamoureux
Supervising Pension Actuary
Actuarial Office

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Chief Actuary
Actuarial & Employer Services Branch